

Decision **PROPOSED DECISION OF ALJ DeBERRY** (Mailed 6/28/2005)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Application of California Water Service Company (U 60 W), a corporation, for an order authorizing it to increase rates charged for water service in the Chico District by \$2,614,975 or 24.20% in fiscal 2005-2006, by \$603,000 or 4.46% in fiscal 2006-2007, and by \$603,000 or 4.27% in fiscal 2007-2008.

Application 04-09-028
(Filed September 27, 2004)

Application 04-09-029
(Filed September 27, 2004)

Application 04-09-030
(Filed September 27, 2004)

Application 04-09-031
(Filed September 27, 2004)

Application 04-09-032
(Filed September 27, 2004)

Application 04-09-033
(Filed September 27, 2004)

Application 04-09-034
(Filed September 27, 2004)

Application 04-09-035
(Filed September 27, 2004)

And Related Matters.

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OPINION APPROVING SETTLEMENT

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OPINION APPROVING SETTLEMENT

I. Summary

Today we approve a comprehensive settlement agreement (Settlement) entered into by California Water Service Company (CWS) and the Office of Ratepayer Advocates (ORA) covering all issues in CWS's general rate increase applications for eight districts: Chico, Visalia, Livermore, Stockton, Salinas, Mid-Peninsula, Los Altos, and East Los Angeles.

Pursuant to this decision, CWS is authorized general rate increases for fiscal year, July 1, 2005-June 30, 2006,¹ in the Chico, Stockton, Salinas, Los Altos, and East Los Angeles Districts. As a result of the Settlement, CWS is ordered to reduce general rates in the Visalia, Livermore, and Mid-Peninsula districts. This decision also authorizes CWS to file future advice letters for certain plant projects and potential expense increases, and to change rates in the "escalation" years, 2006-2007 and 2007-2008 as discussed below. Under the Settlement, the advice letter amounts are capped, and any escalation year increases will not be effective unless CWS has met a "modified recorded earnings test."²

Although we are adopting the Settlement as proposed by parties, we have increased the amount of conservation expenses in each of the eight districts above the amounts included in the Settlement. This exception to the Settlement

¹ Fiscal year 2005-2006 is the test year (TY) in this proceeding.

² The modified recorded earnings test reviews the actual earnings of CWS under agreed criteria and compares this amount to the adopted rate of return for the TY. The adopted rate of return is 8.47%, as further discussed in this decision under VII.G.

reflects our commitment to water conservation and good water management practices.

In addition, today's decision allows CWS to include in rates amounts recorded in CWS's General Office synergies memorandum account, and also finds that it is undisputed that CWS meets all applicable water quality standards.

The amounts of the revenue increases or decreases for each district for fiscal year 2005-2006, and the bill increases or decreases based on average consumption, are shown below in Table 1:

TABLE 1

District	Revenue Increase		Bill Increase³	
	Amount (\$000)	%	Amount (\$)	%
Chico	879.9	7.9	0.88	4.2
East Los Angeles	224.0	1.2	0.38	1.0
Livermore	-67.6	-0.6	-0.33	-0.8
Los Altos	424.8	2.7	1.21	2.1
Mid-Peninsula	-79.2	-0.4	-0.14	-0.4
Salinas	3,305.7	25.8	3.39	15.1
Stockton	2,950.3	14.4	3.63	14.1
Visalia	-62.6	-0.6	-0.80	-4.2

II. Background

This consolidated proceeding is the first CWS general rate case (GRC) processed under the Commission's Rate Case Plan (RCP) for Class A Water Companies⁴ adopted in Decision (D.) 04-06-018 on June 9, 2004. The RCP

³ See, Appendix C.

⁴ Class A Water Companies are those with more than 10,000 service connections.

requires that Class A water utilities file GRC applications on a three-year cycle as required by Section 455.2,⁵ and provides that CWS will file GRC applications for the eight districts in this proceeding based on a fiscal year (2005-2006) estimate rather than using a calendar year, as in prior GRCs. The RCP also provides for two escalation year rate increases following the test year. In this proceeding the escalation years are 2006-2007 and 2007-2008. Escalation year increases include inflation rates applied to expenses, and increases in plant additions, or rate base, in escalation years. These increases are offset by increases in revenues due to customer growth normalized by weather adjusted coefficients. As adopted in the RCP, increases in the escalation years are decreased to the extent the Pro-Forma Rate of Return in the escalation years exceeds the authorized rate of return for the 12 months ending in April prior to the escalation year (for utilities using a fiscal test year). In this proceeding, the Settlement (Appendix L) includes escalation year increases as subject to the modified earnings test.⁶

The consolidated proceeding addresses CWS's general rate requests as set forth in eight applications filed with the Commission on September 27, 2004:⁷

<u>Application</u>	<u>CWS District</u>	<u>Average Customers (2005-2006)</u>
04-09-028	Chico	26,495
04-09-029	Visalia	35,010
04-09-030	Livermore	18,120
04-09-031	Stockton	42,358
04-09-032	Salinas	28,671

⁵ All section citations are to the Public Utilities Code unless otherwise indicated.

⁶ See, Appendix L, p. 44.

⁷ See, Joint Comparison Exhibit, Exhibit 101.

04-09-033	Mid-Peninsula	36,245
04-09-034	Los Altos	18,523
04-09-035	East Los Angeles	26,594

III. Procedural History

In Resolution ALJ 176-3140, dated October 7, 2004, the Commission preliminarily determined the eight applications as ratesetting, and preliminarily determined that hearings were necessary. ORA filed protests in all eight applications. No other responses were received.

A. Prehearing Conference

Administrative Law Judge (ALJ) Bruce DeBerry conducted a prehearing conference (PHC) on November 18, 2004, with CWS and ORA representatives in attendance. With no objections the ALJ consolidated all eight applications into one proceeding. During the PHC, issues were identified, a schedule was discussed, and other matters relating to the proceeding were addressed. In addition, parties discussed a schedule and locations for public participation hearings (PPH), and agreed upon PPHs in Salinas, Stockton, Chico, and a joint PPH to include both the Mid-Peninsula and Los Altos districts.

B. Scoping Memo and Ruling

Assigned Commissioner Michael Peevey's Scoping Memo and Ruling (Scoping Memo) issued December 9, 2004, confirmed the categorization and need for hearing, defined the issues, established a schedule, and designated ALJ Bruce DeBerry as the principal hearing officer and thus the presiding officer.

C. Public Comment

PPHs were held on January 5, 6, 12, and 20, in Salinas, Woodside (Mid-Peninsula and Los Altos districts), Stockton, and Chico, respectively. A total of 22 CWS customers spoke at the hearings. Customers expressed concerns

regarding the rate increase amounts, “rate shock” for some customer classes, water quality, and rate design matters. Some speakers indicated they and other customers were on fixed incomes and would be detrimentally affected by the proposed increases. ORA representatives attended all PPHs, and explained the role of ORA in the proceeding. CWS customer representatives were also present at all PPHs and answered questions and resolved customer problems on an individual basis.

Additionally, a total of 120 letters or e-mails were sent to the Commission’s Public Advisor regarding the eight applications. All of these communications opposed the CWS application, and expressed many of the same concerns stated during the PPHs, including rate shock, water quality, detrimental affects on fixed-income customers, and the overall rate increase amounts.

We consider all of these customer issues in this decision. We express our appreciation to the individuals who took the time to attend the PPHs, or communicate with us, in this proceeding.

IV. Interim Rate Relief

CWS moved on April 21, 2005, for an interim rate increase for all applications effective July 1, 2005. The motion is not opposed by ORA; however, ORA has one concern. ORA explained that if the Settlement is adopted, some CWS districts will have rate decreases effective July 1, 2005. Therefore ORA proposes no interim increases in districts that, if the parties’ Settlement were adopted, would receive final rates that are lower than current rates.

Section 455.2 provides for an inflation-indexed interim rate increase in the event a water utility GRC is not completed in the time contemplated by the

Commission's water RCP. The intent of Section 455.2 is discussed in D.04-06-018,⁸ as well as the implementation issues raised by interim rate relief, and whether a delay in the proceeding schedule is due to actions by the water corporation.

In this proceeding, the Scoping Memo adopted a schedule that anticipated the beginning of evidentiary hearings on March 8, 2005, and a projected submittal on April 18, 2005. On the eve of evidentiary hearings, CWS and ORA requested additional time to discuss a settlement that would address all disputed issues. The ALJ provided parties with the additional time, and on May 2, 2005, parties submitted a joint motion to approve a settlement agreement. Following a hearing to review the Settlement, as discussed below, the Settlement was amended and this proceeding was submitted on June 2, 2005, approximately 45 days after the submittal date anticipated in the Scoping Memo.

We have determined that adopting interim rates is not appropriate. First, we note that this matter will come before the Commission for its consideration only a short time after July 1, 2005; further, the delay past July 1 is largely a result of the need to extend the submittal date. Second, preparation and review of an interim rate decision would have consumed additional resources and might have delayed adoption of final rates under the Settlement. Third, an interim rate increase would have been inappropriate in some districts, and confusing to ratepayers in all districts to the extent that interim and final rate adjustments would follow in rapid succession. In short, an interim rate increase would not be

⁸ See, pp. 21-24.

in the public interest under these circumstances, and therefore we will deny CWS's motion.

V. Settlement Discussions and Hearing

On February 4, 2005, ORA served its reports addressing the eight applications. CWS served its rebuttal testimony on February 28, 2005.

CWS and ORA began settlement negotiations in early March 2005, and at the beginning of scheduled evidentiary hearings contacted the ALJ to report on the status of negotiations and request additional time. The ALJ continued the hearing until March 18, 2005, when parties agreed to provide a further update. Later during the week of March 14, 2005, parties indicated that they had resolved all issues, and the hearing was continued to April 18, 2005, and later to May 2, 2005, in order to document the comprehensive settlement.

On May 2, 2005, a hearing was held to submit the Settlement to the ALJ, schedule the submittal of the Joint Comparison Exhibit (Exhibit 101) to the ALJ, and schedule a hearing date to review the Settlement and Joint Comparison Exhibit.

On May 16, 2005, a hearing was held to review the Settlement and Joint Comparison Exhibit (Settlement Hearing). At the Settlement Hearing, witnesses for CWS and ORA were sworn, and the ALJ asked questions regarding Settlement provisions including parties' proposals for advice letters for uncompleted projects, conservation expenses, water quality, unregulated activities, and other issues resolved in the Settlement and Joint Comparison Exhibit. At the conclusion of the hearing, CWS and ORA exhibits were identified and received, and CWS and ORA agreed to provide an Addendum to the Settlement on May 27, 2005, that would clarify certain unresolved questions, and update some of the expenses.

On May 27, 2005, the assigned ALJ granted the request of CWS and ORA to extend the date for filing the Addendum to June 2, 2005.

On June 2, 2005, CWS and ORA filed the Addendum (Appendix M) and a joint motion to accept the Addendum to the Settlement as a late-filed exhibit. With the receipt of the Addendum, the record was closed.

On June 28, 2005, an ALJ ruling reopened the proceeding for the sole purpose of receiving an additional addendum to the Settlement addressing the American Jobs Creation Act of 2004.⁹

Also on June 28, 2005, CWS and ORA filed the additional addendum (late-filed exhibit, Appendix N) and a joint motion to accept the late-filed exhibit. The matter was submitted on June 28, 2005.

VI. Settlement Criteria

CWS and ORA agree on all disputed issues for the eight applications in this proceeding. In such cases, the Commission applies standards set forth in Rule 51.1(e) of the Commission's Rules of Practice and Procedure (Rules) to evaluate the proposed Settlement. This rule requires that the "settlement is reasonable in light of the whole record, consistent with law, and in the public interest."

In general, we are satisfied that the record supports the requisite findings under Rule 51.1(e). The applicant was represented by its staff and counsel in the proceeding. ORA, whose charge is to represent ratepayer interests, initially protested all eight applications. ORA prepared and served reports covering all aspects of CWS's results of operations, cost of capital, and general office costs for

⁹ The American Jobs Creation Act of 2004 may affect income tax calculations.

the various districts. ORA representatives attended all of the PPHs, and were responsive to inquiries from individual ratepayers. ORA had counsel representing it through extensive negotiations and at the evidentiary hearing. The exhibits proffered by CWS and ORA all have been admitted into evidence. Thus, the sponsoring parties for the Settlement are fairly representative of the affected interests, and their Settlement comes only after a detailed analysis of the utility's case.

The record also shows that the Settlement was reached after significant give-and-take between the parties. The proposed Settlement sets forth the parties' initial positions and final agreement on major issues, supporting tables, and the Joint Comparison Exhibit. Section 454 provides that no public utility shall change any rate except upon a showing before the Commission and a finding by the Commission that the new rate is justified. In their settlement documents and the Joint Comparison Exhibit, the parties have explained their initial positions and what adjustments have been made to arrive at the summaries of earnings and revenue requirements set forth in the Settlement. The resulting rates will produce necessary and sufficient revenues for each of the test and escalation years. At the same time, the Settlement tempers the large rate increases initially sought by CWS; for some districts, the Settlement results in rate decreases, which indicates that the Settlement is responsive to public concerns stated at the PPHs and in communications to the Commission. We find that, except as discussed in VII.D below, the rates and the supporting revenue requirements are justified by the parties' showing and are in the interest of ratepayers and the public. Also, as indicated by the following discussion of major settlement provisions, the settlement documentation is sufficient for the

Commission to discharge its future regulatory obligations with respect to the parties and their interests.

The proposed Settlement, as modified regarding conservation expenses (*see*, VII.D), satisfies the Commission's requirements for a settlement under Rule 51. Specifically, the Settlement, as to each of the eight districts, is reasonable in consideration of the whole record, consistent with law, and in the public interest.

VII. Settlement Overview

The parties' proposed Settlement and Addendum are set forth in Appendices L and M to this decision. These documents, as well as the Joint Comparison Exhibit, contain the original areas of major disagreement and the resolution of these issues. In our review, we organize our discussion according to the three major components of cost-based ratemaking: net operating income, rate base, and rate of return.

A. Net Operating Income

Net operating income is gross operating revenue less operating and maintenance expense, depreciation, income taxes, and other operating taxes. For each of the districts, the parties agreed on the net operating income for Test Year 2005-2006. More detailed information is provided in Appendix A: Summary of Earnings and Rates of Return at Present and Authorized Rates.

B. Water Sales

CWS and ORA reviewed water sales in each of the eight districts separately. Generally, parties agreed on the number of customers in each class, but disagreed on the average customer usage. CWS and ORA resolved these differences by comparing estimates with the most recent data from 2004, and by reviewing why the differences may have occurred. ORA and CWS both used

E-Views¹⁰ as a modeling methodology. Where simple five-year averages of customers did not appear reasonable, parties used an average between their two estimates.

C. Operating, Maintenance, Administrative, and General Expenses

Parties agreed to use the latest purchased water, purchased power and pump tax rates from outside vendors for each district. Parties also generally agreed to use ORA's estimates of district expenses except for certain categories. Transportation expenses reflect 2003 recorded expenses increased by 5% in recognition of increased fuel prices. Customer Accounts and non-specific administrative expenses are based on an average of the positions of CWS and ORA. Uncollectibles and Stores expenses are based on CWS estimates or on five-year averages. In the East Los Angeles, Los Altos, Livermore, and Visalia districts, parties agreed to reduce estimates of added payroll by 40% to reflect in-house maintenance capacity. Expenses were increased above ORA estimates in Visalia and East Los Angeles in recognition of customer growth and in order to improve responses to customer inquiries.

D. Conservation Expenses and Programs

The Settlement recommends ORA's reduced levels of conservation expenses which are based on five-year averages of actual conservation program spending. These reduced expenses are approximately 25-30% of the amounts requested by CWS for the Test Year.

During the Settlement Hearing, the ALJ questioned the parties' proposed conservation programs and expenditures, and requested additional information.

¹⁰ E-Views is a linear regression statistical software package.

In the Addendum, parties continued to recommend that ORA's estimate of conservation expenses be adopted, and recommend the funding of conservation public information and education programs. The Addendum also recommends that any additional conservation funds be spent on cost-effective programs.

Our review of CWS's Urban Water Management Plans (UWMPs)¹¹ for the eight districts and the questions posed during the Settlement Hearing lead us to adopt increases in conservation spending for each of the districts above the amounts recommended in the Settlement. In addition to increasing conservation expenses, we are adopting requirements that will report on how conservation expenses are spent on conservation programs.

Our determination that additional conservation expenses are needed above the amounts recommended in the Settlement results from our analysis of the UWMPs, and our policy to encourage aggressive water conservation programs. First, we note the importance of water conservation and best management practices¹² as explained in the UWMPs, and initiated by D.92-09-084, wherein we stated that, "[t]he Commission will have to deal with conservation and water resource issues far into the future,"¹³ and thus we established that water management plans would be filed in each GRC. We note CWS also recognizes the importance of conservation in managing water resources for all districts and has made this part of its effort to develop an

¹¹ See, Exhibits 5, 9, 13, 17, 21, 25, 29, and 33.

¹² See, UWMPs, Section 6.

¹³ D.92-09-084, 45 CPUC 2d, 630, 634.

integrated management plan.¹⁴ Second, we observe that in every district there is continuing growth in customers and in overall water usage under all three scenarios used in CWS projections.¹⁵ Continuing growth will place continuing demands on existing water supplies, and therefore establishing an effective conservation program now is necessary and reasonable. Third, as explained in the UWMPs' water contingency plans,¹⁶ water shortages due to drought or water supply interruptions would have significant adverse customer consequences. Although each district has its own unique water supplies, and therefore unique contingency plans, certain districts, such as Stockton and Salinas, have continuing problems such as water basin overdraft, salt water intrusion and potential contamination, further arguing for water conservation.

Although the Settlement is based on past amounts actually spent on conservation programs, we can envision a scenario where decreased conservation expense allowances in rates lead to continually decreasing conservation spending, until there is virtually no conservation program at all. That result would be unreasonable. Conservation planning and programs require a sustained effort, both in wet years and dry years, in light of the continued demand on California's limited water supplies. Therefore, we are increasing the amounts of conservation expenses included in rates, and we expect CWS to spend its conservation budget on worthwhile conservation programs.

¹⁴ *See*, UWMPs, Section IV.

¹⁵ *Id.*, Appendix L.

¹⁶ *Id.*, Section 7.

We note that worthwhile conservation programs have been developed, and are defined as Best Management Practices (BMPs).¹⁷ The UWMPs provide that for most of the BMPs in CWS districts the cost/benefit ratios either exceed 1.0 or approach 1.0, an indication that overall benefits exceed costs. Furthermore, cost/benefit ratios for the large landscape and conservation program, and commercial and industrial program are significantly above 1.0. These factors indicate there is no shortage of cost-effective and worthwhile conservation programs.

In order to give CWS latitude in applying the conservation program budgets to worthwhile programs, we will not direct how these amounts are spent, but we will order CWS to report on its conservation spending as part of its UWMPs in the next GRCs for these eight districts. We expect that CWS will continue its public information and school educational programs as recommended by the Settlement. However, we expect CWS to spend the remaining conservation amounts on the BMP programs with emphasis on those that are most cost beneficial. We also expect that in the next GRCs ORA will study and analyze CWS expenditures and recommend any appropriate Commission action.

Our adopted conservation expenses are as shown below:

<u>District</u>	<u>CWS Estimate</u>	<u>ORA Estimate and Settlement Recommendation</u>	<u>Adopted</u>
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(In Thousands of Dollars)

¹⁷ *Id.*, Section VI.

Chico	32.4	8.1	20.2
Visalia	56.3	14.1	35.2
Livermore	68.0	17.0	42.5
Stockton	118.0	29.5	118.0
Salinas	66.6	16.7	66.6
Mid-Peninsula	146.7	36.5	91.6
Los Altos	85.5	21.4	53.4
East Los Angeles	101.3	25.3	63.3

E. General Office Expenses

General Office Expenses are incurred to operate CWS's general office in San Jose, California. As explained by CWS, functions of a multi-district water utility are more efficiently accomplished in a single location rather than duplicated in each district.¹⁸ ORA initially recommended that all incremental General Office positions allowed in 2001, 2002, and 2003 rate cases be disallowed, as ORA believed the costs for many of these positions had been included in rates, but went unfilled. In the Settlement, parties agreed to include some positions in expenses; however, other positions would only be included in rates after CWS had filled the positions. Consistent with the method adopted in D.04-07-034 for San Gabriel Valley Water Company, CWS would file an advice letter to include the costs for these positions, and associated equipment, in rates. Under the Settlement, advice letters will only be filed in May of each escalation year. The Addendum, Attachment 3, delineates the 15 positions that would be included in rates under this advice letter process. The estimated payroll cost of these positions is approximately \$880,000.

¹⁸ See, Exhibit 34, pp. 2-3.

Parties also agreed use the 2004 recorded ratios of health care costs to payroll (14.323%), and 2004 retiree health care costs to payroll (3.019%), to determine estimated health care expense and retiree health care expense. Parties included the synergies resulting from the Dominguez merger in estimates of property insurance and pensions and benefits expenses.

F. Rate Base

1. Plant Additions

Parties agreed to use ORA's estimates of plant additions, and to include in the Joint Comparison Exhibit the deferred income tax component of rate base to reflect changes in tax depreciation due to the Tax Relief Act of 2003. As discussed below, parties also agreed on an allocation of plant to non-regulated activities, thus removing this plant from customer rates.

An important feature of the Settlement is the proposal to exclude many plant additions pending the completion of these additions. Parties propose that as each plant addition is completed and in service, CWS may recover the cost through an advice letter filing.¹⁹ Furthermore, each plant addition will be "capped," thus establishing the maximum amount that can be included in each advice letter. Should the recorded cost exceed the cap for any plant addition, the excess cost will be reviewed for reasonableness in the next GRC for the specific district in which the plant addition is located.

¹⁹ Potential plant additions including the cap amounts are listed in Appendix M, Attachment 2.

2. Allocation of Plant and Expenses to Non-Utility Activities

As explained by ORA,²⁰ CWS conducts non-tariffed activities in the Chico, Visalia, Livermore, Salinas, and Stockton districts. These non-utility activities include work done by CWS employees through contracts with unregulated enterprises. Prior to the Settlement, CWS transferred portions of district expenses to shareholders. However, ORA recommended that in addition to expenses, a portion of common plant in each of these districts should also be removed from district plant amounts that are included in rates.

In the Settlement, parties agreed to allocate an amount of common plant to shareholders in the Chico, Salinas, Livermore, and Visalia districts. In the Stockton district, parties determined that no common plant was used in the non-utility contract activities, and therefore only expenses are allocated to shareholders.

In addition to these non-utility activities, CWS also provides district sites used for antennas, such as cellular towers. These passive activities do not require service work by CWS employees, and CWS credits ratepayers with 30% of contract revenues.

In addition to in-state non-utility activities, CWS incurs General Office expenses to manage out-of-state utilities not regulated by this Commission. As discussed in the Settlement, CWS was allocating approximately 3% of its general non-billing expenses²¹ to unregulated activities including the out-of-state

²⁰ See, Exhibit 71, pp. 2-5 to 2-14; Exhibit 72, pp. 4-5 to 4-11; Exhibit 73, 4-5 to 4-11; Exhibit 74, p. 4-4; and Exhibit 75, p. 4-4.

²¹ Non-billing expenses are expenses not otherwise directly billed to the unregulated activity. CWS currently allocates 6.1% of billing expenses to unregulated activities, and this allocation is continued under the Settlement.

utilities. However, in the Settlement, parties have agreed to increase this allocation to 5.1%, resulting in a downward adjustment of \$460,700 to General Office Expenses.²²

As a result of ORA's concern regarding unregulated activities, and CWS's General Office Expense allocations to these activities, parties agreed that in future rate case filings, CWS will provide specific information on revenues and cost allocations. This information is discussed in Settlement Sections 2.62 and 2.63. Parties also agreed that an audit will be conducted prior to the CWS 2007 GRC. The audit will review whether allocations were made in accordance with provisions of the Settlement, and with written allocation policy CWS develops before 2007. Parties further agreed that audit costs will be borne by CWS.

G. Rate of Return

CWS requested rates of return of 9.48% (2005), 9.57% (2006), 9.80% (2007), and 9.82% (2008). ORA recommended rates of return of 8.19% (2005), 8.24% (2006), 8.27% (2007), and 8.29% (2008). Although CWS and ORA agreed on capital structure, and the cost of debt and preferred stock, CWS requested a return on equity of 12.15%, while ORA recommended 9.61%.

As noted in Settlement Section 2.3, parties considered recent returns on equity for water utilities, and agreed on a 10.10% return on equity, which we adopt.

As we are adopting the Settlement in whole as requested by parties, except for increased conservation expenses, evidentiary hearings did not test the cost of

²² Parties also agreed to ORA's recommended allocation of 4.5% of General Office plant to non-tariffed activities.

capital testimony. We recognize that the Settlement is the result of a negotiation process on all contested issues including cost of capital. However, we note that many aspects of this decision provide significant protections to CWS against erosion of earnings, including the use of recent expense estimates, provision for future advice letter filings regarding major plant additions and expenses, and allowance for escalation effects in escalation years 2006-2007 and 2007-2008. In addition, CWS is protected through separate balancing accounts for purchased water, purchased power and pump taxes, and memorandum accounts for catastrophic events and waste contamination. The result of these protections is to reduce the risk that CWS faces with regard to its opportunity to earn its return on equity. Consequently, we expect that in future proceedings all of these existing and adopted protections against erosion of future earnings will be given their proper weight in the determination of risk and consequently return on equity.

VIII. Summary of Earnings and Revenue Requirement

Table 2 compares CWS's and ORA's initial positions on revenue requirement increases for TY 2005-2006 for the eight applications, and the revenue requirement increase proposed in the Settlement.

TABLE 2²³

District	Proposed Revenue Requirement Increase (\$000)		
	CWS	ORA	Settlement
Chico	2,614.9	380.2	867.0

²³ See, Joint Comparison Exhibit (Exhibit 101).

East Los Angeles	2,219.7	-2,084.5	181.5
Livermore	1,432.1	-370.6	-95.0
Los Altos	2,912.0	827.7	390.4
Mid-Peninsula	3,227.1	-474.0	-139.4
Salinas	5,864.5	2,528.3	3,251.1
Stockton	5,548.5	1,119.8	3,738.3
Visalia	2,688.1	-269.1	-85.0

Parties propose that the Commission adopt their Settlement on each of the districts' revenue requirements based on the calculations set forth in the Joint Comparison Exhibit, Exhibit 101. The Summary of Earnings which includes the revenue requirements at present and proposed rates for each of the eight districts is shown in Appendix A. The corresponding adopted quantities are shown in Appendices D through K for each district.

IX. Escalation

The parties agreed that the Commission should authorize step and escalation increases for the eight districts in this proceeding using a "modified recorded earnings" methodology set forth in Appendix L, Section 2.71. This methodology relies on the weather coefficients described in Appendix M, Section 5.10, and included in Appendix M, Attachment 1.

X. Rate Design

Parties agreed to consolidate rate schedules in the Salinas district, as the customers of recently acquired smaller systems would not be negatively impacted by a uniform rate schedule. However, in the Visalia district, the customers of recently acquired systems were served under tariffs significantly different from those of existing CWS customers, and therefore parties agreed not to consolidate rates in the former EPTCO and TULCO systems until July 1, 2007. Instead, rates for EPTCO and TULCO customers will be raised to reduce the

difference with other Visalia customer rates by one-third in 2005, and by an additional one-third in 2006.

Tariffs reflecting our adopted revenue requirements at proposed rates for each district are shown in Appendix B.

XI. Water Quality

In D.04-05-060 (A.03-10-017, A.03-10-018, A.03-10-019, A.03-10-020, A.03-10-021) adopted May 27, 2004, the Commission addressed water quality issues in five CWS districts including Stockton, Salinas, and Mid-Peninsula regarding the contaminate 1,2,3-Trichloropropane (TCPA). In an expedited hearing, CWS stated that no TCPA problem existed in the Mid-Peninsula district, while additional testing confirmed non-detectable levels of TCPA in the Salinas and Stockton water systems.²⁴ Although the Salinas, Stockton and Mid-Peninsula applications were dismissed in that proceeding, CWS was authorized to maintain memoranda accounts for capital expenses related to water quality. These memoranda accounts will be subject to later review for reasonableness.

In this proceeding, CWS provided testimony regarding water quality in all eight districts including Stockton, Salinas, and Mid-Peninsula. CWS testimony, provided by its water quality expert, stated that CWS met all state and federal drinking water standards for all eight districts.

In the Settlement, parties request that the Commission make a finding of fact that CWS meets all applicable water quality standards. During the Settlement Hearing, the ALJ questioned this request, and CWS stated, with the

²⁴ See, D.04-05-060, pp. 2-5.

concurrence of ORA, that CWS has resolved all outstanding water quality issues, and meets all federal and state drinking water standards.

XII. Comments on Proposed Decision

The proposed decision in this matter was mailed to the parties on June 28, 2005, pursuant to Pub. Util. Code § 311(d) and Rule 77.1. As all parties stipulated to a 10-day comment period, the normal 30-day comment period was reduced, and no reply comments were permitted.

On July 11, 2005, ORA provided comments supporting the proposed decision, but noting certain corrections to tables, and the appendices. These corrections have been incorporated into today's decision.

XIII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Bruce DeBerry is the assigned ALJ in this proceeding.

Findings of Fact

1. CWS has entered into a Settlement with ORA for all eight districts in this proceeding. The Settlement resolves every disputed issued between CWS and ORA for all eight CWS districts.
2. The active parties, ORA and CWS, reflect the affected interests in this proceeding.
3. No term of the proposed Settlement contravenes statutory provisions or prior Commission decisions.
4. The Settlement conveys sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties and their interests.
5. No party opposes approving the proposed Settlement.

6. Conservation programs are a necessary and reasonable way to manage water resources.

7. Customer growth and increasing water usage are projected under all scenarios used by CWS for future years.

8. Overdraft of existing water basins, potential contamination of water supplies and salt water intrusion affect water supplies in the Salinas and Stockton districts.

9. Many of the BMP conservation programs have cost/benefit ratios exceeding 1.0.

10. The large landscape and conservation program and the commercial and industrial conservation program have cost/benefit ratios significantly exceeding 1.0 in all eight CWS districts in this proceeding.

11. The summaries of earnings presented in Appendix C, based on the parties' Settlement, are reasonable, justified, and sufficient for ratemaking purposes.

12. At the time this proceeding was submitted, it is undisputed that CWS meets all applicable federal and state water quality standards in the Chico, Livermore, Stockton, Salinas, Mid-Peninsula, Los Altos, Visalia and East Los Angeles districts.

Conclusions of Law

1. Except for the treatment of conservation expenses, the proposed Settlement satisfies the requirements of Rule 51(f). The proposed Settlement should be adopted except for reasonable increases in conservation expenses.

2. The revised rates, step increases, and tariff rule revisions set forth in Appendix B, based on the parties' Settlement and adjusted for increased conservation expenses, are justified.

3. At the time this proceeding was submitted, it is undisputed that CWS meets all applicable federal and state water quality standards in the Chico, Livermore, Stockton, Salinas, Mid-Peninsula, Los Altos, Visalia and East Los Angeles districts.

4. Today's decision should be made effective immediately.

O R D E R

1. The Joint Motion to Approve Settlement Agreement between California Water Service Company (CWS) and the Office of Ratepayer Advocates (ORA) is granted, and the Settlement Agreement as set forth in Appendix L, except for increased conservation expenses, is adopted.

2. The Joint Motion of CWS and ORA to Accept Addendum to Settlement Agreement As A Late-Filed Exhibit is granted. The Addendum as set forth in Appendix M is adopted.

3. The Joint Motion of CWS and ORA to accept A Late-Filed Exhibit is granted. The Late-Filed Exhibit as set forth in Appendix N is adopted.

4. The summaries of earnings shown in Appendix A, and the quantities and calculations included as Appendices D through K to this order that underlie them, are adopted.

5. CWS is authorized to file in accordance with General Order 96-A, or its successor, and to make effective on not less than five days' notice, tariffs containing the Test Year 2005-2006 increases for its districts as provided in Appendix B to this order. The revised rates shall apply to service rendered on and after the tariff's effective date.

6. Subject to the modified recorded earnings test based on weather-adjusted recorded earnings for the last 12 months ending March 31 each year, as provided

in the Settlement Agreement attached to this order, CWS is authorized to file in accordance with General Order 96-A, or its successor, and to make effective on not less than five days' notice, tariffs containing the Escalation Years 2006-2007 and 2007-2008 increases for CWS districts.

7. Advice letters for authorized rate increases for 2006-2007 and 2007-2008 may be filed in accordance with General Order 96-A or its successor no earlier than May 1 of each year, together with appropriate work papers. The increases shall be the amounts authorized herein, or a proportionate lesser increase if CWS's rate of return on rate base, adjusted to reflect rates then in effect, normal ratemaking adjustments, and step increase advice letters in the modified earnings test based on weather-adjusted recorded earnings for the 12 months ending March 31 each year, exceeds 8.47%. The advice letters will be reviewed by the Commission's Water Division for conformity with this decision, including the applicable provisions of the Settlement Agreement (Appendix L) and the Joint Comparison Exhibit (Exhibit 101), and shall go into effect upon the Water Division's determination of compliance, not earlier than July 1 of the fiscal year for which the increase is authorized, or 30 days after filing, whichever is later. The tariffs shall be applicable to service rendered on or after the effective date.

8. CWS is authorized to file advice letters to recover costs for CWS's district projects as described in Appendix M, Attachment 2, and as set forth in Appendix L.

9. CWS is authorized to file advice letters to recover the costs of up to 15 specific General Office personnel after each has been hired, as set forth in Appendix M.

10. CWS is authorized to recover the General Office synergies memorandum account through December 31, 2004. This recovery shall be through a 36-month rate surcharge as shown in Appendix M, Section 5.12.

11. CWS shall report on the conservation expenditures adopted in this order in its next general rate cases for the Chico, Stockton, Livermore, Salinas, Visalia, Mid-Peninsula, Los Altos, and East Los Angeles. Each district's report shall address how CWS expended the district's conservation budget. CWS may include the report in its Urban Water Management Plans filed with each district's general rate case.

12. Application (A.) 04-09-028, A.04-09-029, A.04-09-030, A.04-09-031, A.04-09-032, A.04-09-033, A.04-09-034, and A.04-09-035 are closed.

This order is effective today.

Dated _____, at San Francisco, California.